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SIPDIS

TREASURY FOR SCHMERIN, DEPARTMENT FOR EUR/SCE, EEB/IFD/OMA  
(FREUDENWALD)

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SUBJECT: BOSNIA: IMF DEAL DELAYED

REF: A. SARAJEVO 589

[1](#)B. SARAJEVO 666

[1](#)1. Summary. On June 22, the IMF postponed a scheduled June 29 governing board meeting at which the IMF was to approve a proposed \$1.5 billion, 3-year standby arrangement because IMF conditions have not been met. The conditions included budget cuts at all levels of government. The RS entity and the state-level government achieved the necessary cuts, but the Federation entity failed after capitulating last week to war veterans protesting proposed cuts to their benefits. Federation politicians from the ruling SDA party threaten to reject the IMF agreement if they are required to cut benefits to veterans and invalids. The Federation Finance Minister (a member of HDZ) says without the IMF loan, the Federation will be bankrupt by September or October. The RS is in similarly dire straits, and asked the IMF for separate financial support, a proposal the IMF rejected. End summary.

[1](#)2. The failure of BiH to comply with conditions set by the IMF has caused a delay in the approval of the standby arrangement negotiated in May (Ref A). The conditions included rebalancing the entity budgets and cutting the state budget, the adoption of a state- (national-) level excise tax law, and the adoption of a coordinated budget framework. Some of the conditions have already been met; the excise tax law passed last week, the Republika Srpska (RS) entity completed its rebalancing, and the state government cut its budget. The Federation was on its way to meeting the conditions after the government forwarded to parliament last week a budget law slashing civil servant salaries and social benefits by 10% across the board. This led on June 18 to violent protests from war veterans ) a consistently vocal and powerful lobby - and caused the Federation government to quickly capitulate and agree to find cuts elsewhere.

[1](#)3. In a meeting with the IMF on June 22, the IMF rejected the Federation,s suggestion that it make the necessary budget cuts elsewhere, saying that BiH could not change its letter of intent (which explicitly mentioned cutting veterans, benefits) after it had already been distributed to the 160 member states. With elections coming in 2010, Federation officials are politicizing the issue, making it less likely an agreement can be reached. SDA President Tihic announced that his party will accept no agreement that cuts benefits to war veterans. Federation Finance Minister Bevanda, a member of HDZ, said he had no alternative plan, and that without the IMF loan, the Federation could go bankrupt as early as September.

[1](#)4. RS officials are unhappy with the situation. An assistant to the RS Finance Minister told us &the RS will suffer<sup>8</sup> because of the Federation,s failure. He expressed hope that the international community will pressure the Federation to meet its obligations. Nevertheless, he assured us that the

financial stability of the RS &will not be endangered8 if the IMF funds are not released. Yet media reports and our earlier conversations with the IMF staff indicate the RS budget faces serious problems. It was also reported that RS Finance Minister Dzombic requested separate financial assistance from the IMF when he learned of the delay. The IMF rejected the request.

15. Since the announcement of the delay, no mention has been made of the third IMF condition, which requires BiH to adopt a coordinated budget framework. This condition has not been fulfilled either. A draft framework exists, but has not yet been approved by the National Fiscal Council (NFC) due to opposition from state Finance Minister Vrankic. Vrankic claims the current formulation starves the state of needed funding. The media has not focused on this condition, and we are trying to find out where it currently stands.

16. If the IMF loan ultimately falls through, there will be other repercussions. The EBRD, IMF and the European Commission (EC) recently secured an agreement from European banks present in BiH (HypoAdria, Raiffeissen, Volksbank, NLB, UniCredit and Intesa Paolo) to not withdraw capital from BiH. This agreement was contingent upon the approval of the IMF standby arrangement. An 185 million KM loan from the World Bank for budget support (which would go mainly to the entities) was also dependent on the approval of the standby arrangement.

17. Comment. The IMF arrangement is not yet dead, but it will require a herculean effort on the part of the all but dysfunctional Federation to resurrect it. This will be extremely difficult given the pressures the 2010 elections will place on politicians. That said, the cost of failure is

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much higher. The war veterans and everyone else will lose if the Federation goes bankrupt and cannot pay benefits at all. Meanwhile, the RS, which is also in financial trouble, may itself become increasingly angry as the Federation,s failures block the IMF aid hat the RS may desperately need. End comment.  
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